Paving the Way Forward for Rural Finance
An International Conference on Best Practices

Case Study

Risk Management: Islamic Financial Policies

Case Study of Bank Indonesia

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This case study was made possible by support provided in part by the US Agency for International Development (USAID) Agreement No. LAG-A-00-96-90016-00 through Broadening Access and Strengthening Input Market Systems Collaborative Research Support Program (BASIS-CRSP) and the World Council of Credit Unions, Inc. (WOCCU).

BANK INDONESIA

I. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) historically have played significant roles in the Indonesian economy. This is because of their high proportion in Indonesia economic activity in terms of the number of enterprises, employees as well as their outputs.[1] MSMEs are also important players in the development of local economies and communities. This is due to their close link to the local economy. They are also the creators of new markets and the introducers of innovation. MSMEs are often directly exposed to ever-changing market conditions and tend to have a more flexible organization and quicker decision making processes than large enterprises so that they are quick to react to such changes. They can often create new markets by responding to new market opportunities and by taking advantage of innovations.

The majority of Indonesia's 40 million MSMEs has no access to formal financial institutions, especially to commercial banks. This is because most of them are family businesses that do not have any legal status. Most of them also do not have any formal operational procedures and well-prepared transaction records that usually become a basic administrative requirement to get credit from banks. Referring to the census data, of all MSME in Indonesia, only 60,000 MSME get loan from banks, 113,000 from cooperatives, and 62,000 from Non-bank Financial Institutions.[2]

The important of banking services for micro and small-scale entrepreneurs involves not only for the provision of credit facilities but also for providing savings and remittance facilities. Therefore they can gain self-reliance through accumulating their own equity. However, some MSMEs could generate profits by using credits from banks, either to deal with seasonal fluctuations or to expand and to modernize their operations, and this is reflected in the rapid absorption of increased micro-loans as they are made available in the Indonesian market.

Despite of commercial banks difficulties to distribute loans to MSME, Indonesia has been among the leaders in developing specialized financial institutions to serve MSME to complement the informal market. Simple and well adapted credit approval and supervision procedures, often coordinated with appropriate technical assistance and a careful attention to the socio-cultural aspects of the communities concerned are all the aspects that support the successful of microfinance in Indonesia.

However, there are some Moslem MSMEs in Indonesia who would not use the conventional bank[3] services which uses interest that is not in accordance with

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[1]There are almost 40 millions MSME and they account for over 98% of all enterprises in Indonesia and cover over 60% of Indonesia’s GNP based on 1996 Economic Census from Central Board of Statistic

[2] The census data shows that some of credit are certainly for consumption, but they seem indicated that there is a larger number of business borrowers than the census figures. See 1996 Economic Census from Central Board of Statistic Tables 20 and 21.

[3] The term “conventional” defines an interest-based bank or banking system.

Islamic values.[4] To accommodate this group of MSMEs, the government provided a possible condition by establishing Islamic banks along side with the existing conventional bank in 1992. Furthermore, in order to create more banking that can serve MSMEs, Bank Indonesia renew the whole potential of Indonesian banking including Islamic Rural Banks so that their roles can be strengthened to accelerate economic recovery and to alleviate poverty.

Capital inadequacy and lack of collateral are just few of the constraints faced by MSMEs. Other constraints are the inadequacy of entrepreneurship, production, managerial and marketing capabilities. These inadequacies increase a bank's financing risk. To reduce the risk, it is necessary that financial assistance to be provided simultaneously with other forms of assistance to enhance production, marketing and managerial capabilities. Bank Indonesia has observed that financial assistance is easier to be promoted once the enterprise obtains such assistances.

Bank Indonesia has considerable experience with technical assistances in its Micro Credit Project (PKM) and Self-Help Group Linkage to Banks (PHBK) projects. Few of these programs provide technical assistance to lending institutions. At earlier periods, some programs were funded by USAID, GTZ, and Asian Development Bank working with village financial institutions, and almost all such assistance is now handled through Bank Indonesia.

The paper is organized as follows. Section 2 underscores the banking system in Indonesia. Section 3 discusses how the role of Bank Indonesia in developing small and micro enterprise in Indonesia. Section 4 explains the development of Islamic banking in Indonesia. Finally, section 5 highlights the key challenges lying ahead to foster further development of Islamic banking and its prospect in Indonesia.

II. The Indonesian Banking System

The Act No. 23 of 1999 concerning Bank Indonesia that revises the former act No.13 of 1968 states that the objective of Bank Indonesia (BI) as a central bank is to achieve and to maintain the stability of the country currency unit (Rupiah). To achieve the objective, BI has a role in formulating and implementing the monetary policy, regulating and safeguarding the smoothness of the payment system, and also regulating and supervising banks. Refer to the Act, BI gets its independency since other party shall not intervene BI in discharging its tasks.

Furthermore, the New Act diminishes the role of BI as an agent of development as stipulated in the previous Act. As an agent of development, BI was given a strong development mandate to improve people's standard of living by regulating, safeguarding and maintaining the stability of the value of the Rupiah; and promoting stability of production and development, as well as expanding employment opportunities. This was conducted to support the priority sectors by using liquidity credits (KLBI) such as for maintaining the self-sufficiency in food, developing cooperatives and providing fund for MSMEs. However, despite its

[4] Actually the business and economics transaction which is according to Islamic principles have been long practiced traditionally among Indonesian community. The profit and loss sharing system have been known in agricultural sector between land owner and tenants since long time ago.

support on government development policies, those KLBI had also brought negative impacts, such as inflationary pressure and bank's dependence on BI. As refer to the new Act, then the liquidity credits shall be transferred to a state owned enterprise designated by the Government. BI shall no longer extend any KLBI under the credit program. The transfer also includes the transfer of channeling loan, which funds derived from foreign parties and technical assistance given in the extension of credit program.

Based on the Act of the Republic of Indonesia No. 7 of 1992 concerning Banking as amended by the Act No. 10 of 1998, banks are categorized as commercial banks, and rural banks (*Bank Perkreditan Rakyat/*BPR). Hence, BI regulates, issues and revokes banks' licenses, supervises both commercial banks and rural banks.

The commercial banks have access to the payment system and offer a full range of banking products. The total number of commercial banks (including commercial banks under Islamic principles) are 141 banks included 26 Regional Development Banks owned by Provincial Government, 5 state owned banks, 10 foreign banks, 30 joint venture banks, and 69 private national banks with 6,981 bank offices. The commercial banks still dominate the banking industry in Indonesia. The number of total assets, total third party deposits, and total loans as of December 31, 2002 reached Rp1,095.8 trillions, Rp845 trillions, and Rp365.4 trillions respectively.

Rural banks are extremely small sized banks compared to regular commercial banks. Rural banks can only be owned by Indonesian citizens, corporate or partnership that is 100% owned by Indonesia citizen. They could take deposits and distribute loans, but do not have access to the payments systems. Therefore, they are not allowed to offer checking or current accounts to the public. Rural banks also must not deal with foreign exchange transactions and must not deal with foreigners either in Rupiah or in foreign currency. The total number of BPR (including rural banks under Islamic principles) as of December 31, 2002 was 2,141 BPR with 2,745 bank offices and the total asset, total third party deposits and total loan was amounted to Rp9,079.6 billions, Rp6,126.01 billions, and Rp6,682.86 billions respectively.

III. Key Success Story of Rural Financing in Indonesia

1. Indonesian Rural Banks

Microfinance in Indonesia has a long history stretching back to more than 100 years ago. It is provided by formal and informal agents. The formal sector agents consist of the commercial banks (*BRI Unit*), the rural banks (*BPR*), savings and credit cooperatives (*Koperasi Simpan Pinjam/Kosipa*), Village Credit Board (*Badan Kredit Desa/BKD*), Rural Fund and Credit Institutions (*Lembaga Dana Kredit Pedesaan/LDKP*) that have been granted BPR licenses, and Village Unit Cooperative (*Kredit Unit Desa/KUD*). The informal sector agents include various sorts of Non Government Organizations (*Lembaga Swadaya Masyarakat/LSM*) and Self Help Groups (*Kelompok Swadaya Masyarakat/KSM*), moneylenders, local sources of trade and consumer credit, and mutual credit arrangements especially *Arisan* and *Gotong Royong*, the indigenous forms of Rotating Savings and Credit Associations (ROSCA).

The number of microfinance institutions that serves people in rural areas is thousands due to the economic growth in rural areas and the huge number of MSMEs that grows extensively and now reaches about more than 40 millions.

The profile of Indonesia MFIs could be found at the table below:

Types of MFIs	Total Unit	Number of Borrower (mio)	Total Loan (Bio Rp)	Average Loan (Thousand Rp)	Total Deposits (Bio Rp)
BRI Unit 1)	3,825	2.8	10,300	3,679	22,400
BPR (Rural Bank) 2a)	2,141	1.82	6,683	3,672	6,126
Village Credit Board (BKD) 2a)	5,345	0.50	182	364	19
Saving and Loan Coop. (Kosipa) 3)	1,097	0.66	531	804.5	85
Saving and Loan Unit (USP) 3)	35,218	NA	3,629	NA	1,157
Rural Fund and Credit Institution (LDKP) 2)	2,272	1.3	358	275.4	334
Baitul Mal Wat Tamwil (BMT) 4)	3,038	1.2	157	130.8	209
Pawnshop 2)	692	>15	973	NA	NA

1) Data January 2002
2) Data December 2000
2a) Data December 2002
3) Data April 1999
4) Data December 2001
Sources : Bank Indonesia, PT BRI, State Ministry of Cooperatives and MSME, Finance Ministry, Pawnshop, and BMT Association

Referring to the census data from Central Board of Statistic, rural banks that are BPR and BRI Unit recorded as a leader of microfinance that serve MSMEs in rural areas. However, most of them are located in the islands of Java and Bali, and are relatively sparse in the eastern islands. This is because Java and Bali involves high economic activities in rural areas. They play a vital role in developing rural areas because they are located are sparse in the village area with different characteristics, they are closed to the community, loan procedures are very simple and quick, and personal approaches are practices to get the customers.

Right now rural banks that are BRI units and Rural Banks (BPR) are the leader in the microfinance sector.

The successful of BRI Unit is majority generated by the strong networking, information system, saving products development, innovative and flexible loan terms. They are also supported by professional human resources to have close monitoring on loan performances.

BPR Industry also records great performances. The number of BPR as of December 2002 was amounted to 2,141 units, decreased compared to the number as of December 1998 (2,262 units). However, the number of BPR offices increased from 2,319 units to 2,745 units. The data shows that good BPR weathered much better in the economic crises compared to commercial banks. They can expand and develop their businesses. Total assets increase from Rp2,751 billions at the end of 1998 to Rp9,080 billions at December 2002 or increase about 230% in 5 years. Total loans increase from 1998 to 2002 that are from Rp1,861 billion to Rp6,683 billions and total third party deposits increase from Rp1,500 billions to Rp6,126 billions.

As an illustration of a success BPR, attachment 1 is a case of PT BPR Usaha Karya Mandiri (UKABIMA) that is one of recorded success BPRs. Total assets as od December 2002 was amounted to Rp27.97 billion. UKABIMA was formed in 1996 by three Indonesian shareholders. The shareholders are supported by international agencies for financial and technical assistances. UKBIMA now has 44 BPR in networking. The borrowers and savers reach 51,470 persons and 130, 511 persons respectively. The percentage of women borrowers is 40%. Total assets, loan portfolio

From the case of UKABIMA, the learning points of a successful BPR are a strong capital support, strong networking, technical assistances to the borrowers in line with financial assistances, consultation and a close supervision from the holding to its BPR subsidiaries, innovative products that attract the customers, and an integrated software system.

As refer to the Bank Indonesia Act in 1999, the role of BI to support rural banks is concerned with the aspect of financial sector development, not specifically with the poverty alleviation. This is conducted by implementing policies concerning its core functions in monetary management, payment system and banking supervision. Along with the improvement on the credit schemes and attention on special BPR development problems, BI has been undertaking studies to enhance MSMEs and BPR either in capital or managerial capabilities. Based on the study, it then determines success factors, either in the form of industry restructuring, human resources capabilities, capital or business opportunities and critical issues for BPR development, which will be followed by consulting and training. Under the new prevailing act, BI's role will take a different paradigm, in which what we can do is in the part of capability and institutional building of BPR as to provide technical assistance and supporting efforts to create a supporting environment for the purpose of BPR development.

BPR as a “sub” of the finance is shaped by a number of factors, internal as well as external. Among others, internal factors are human resources, source of capital and managerial capability, while external factors are public confidence, competition, monetary and fiscal policy, and political will. BI then develops strategies to deal with those problems as to strengthen the role of BPR by restructuring the BPR industry as a first step and followed by capacity building, improving the regulation and supervision, developing a standardized training program to increase the quality of BPR human resources, and also supporting the linkage program between commercial banks and BPR.

The purpose of BPR restructuring is to clean up troubled BPR and in turn to have an industry that is sound, sustainable and profitable. Until December 2002, Bank Indonesia has revoked 213 BPR licenses. Under the blanket guarantee program, the government did payment for third party deposits.

In cooperation with GTZ ProFi[5], BI is improving the regulation and supervision of BPR. This is including formulizing a simpler set of reporting and monitoring formats that the supervisors will be able to concentrate a smaller staff on response to troubled areas, rather than paying too much attention to routine evaluation of banks that are running well, evaluating the CAMEL factors to be more appropriate to BPR characteristics even they are probably a little bit tougher than the current system, issuing the regulation of fit and proper test for prospective commissioners and directors of BPR. Those new regulations are to increase the good corporate governance of BPR management.

The capacity building is important to strengthen the industry of BPR. BI is continuing processing the establishment of the deposit protection scheme (DPS) in line with commercial bank, rating agency for BPR, setting up the Standardized Certified Training for managers of BPR (a cooperation program with GTZ ProFi, Germany), building a database information system to have an access of BPR data quicker and more efficient.

BI also is facilitating the linkage program between commercial banks and BPR to develop BPR and also to distribute loan to MSMEs since commercial banks do not have any capacity to serve loans for MSMEs that are mostly located in rural areas. This program was promoted last year and as of December 2002, 819 BPRs and 21 Banks have been participating in the program with the total outstanding balance is Rp347,330 millions.

Many international institutions that are GTZ ProFI, USAID, and Asia Foundation are supporting the development of BPR industry by giving technical and financial assistances. USAID and the Asia Foundation is also supporting several programs that are rating agency establishment, and restructuring program for BPR in Jakarta (the capital city) and it’s surrounded area.

[5] ProFi is a project based on government agreement between the government of Indonesia and Germany to promote the micro and small financial institution that is started in 1999 and still continuing until now.

2. Small Scale Enterprises Development Project

One of technical assistances giving to banks for extending services to various forms of small-scale businesses was PPUK (Small-scale Enterprises Development Project). In the long term, this project aimed to create a small-scale credit model, which did not only use the commercial banking approach but also using the development banking approaches that were currently needed in the third world countries.

The role in enhancing microfinance programs also fulfilled with assistance from international institutions, such as in the field with PHBK projects (Self-help group linkages to banks) from 1989[6]. BI relied on the services of "self help promoting institution" which include NGOs, to nurture the linkages. During 1990s, PHBK made progressively greater use of BPR system to link directly with the self-help groups in their local areas. It was expected that handling banks could extend small-scale credits to the self-supporting groups under an accountable system.

Another project, namely PKM (microcredit project) was declared with the objective to develop micro-businesses in the rural areas that in turn will improve income and job opportunity in those areas. PKM, the project in cooperation with the Asian Development Bank (ADB), was signed by the government of the Republic of Indonesia and ADB on January 1995. This project then was started on July 21, 1995 and ended in December 2001. PKM was also stressed to enhance women's role and to alleviate poverty.

The project has dual side strategy, from the supply side and demand side. The strategy from the supply side is to strengthen the rural financial institutions that are BPR and Village Credit and Loan Institutions (LDKP). The program was conducted by giving training for the manager and staff of those institutions and loans for motorcycle and computer. From the demand side, the strategy implemented is to develop the micro businesses by distributing loans through BPR and LDKP with market rate. However the program is not including Islamic rural banking since pre requisite of the ADB loan is an interest based loan.

The performance of the credit is very sound. The current loan per December 2002 was more than 90% and only 6% that was at the doubtful and loss position. The total participated institutions of the project are 1,140 consists of 843 BPR, 226 LDKP, 65 LPSM and the total borrowers reach 930,235 persons consists of individual borrower (84.19%) and a group (15.81%). However, the program is quite success as it is also supported by strong requirements for BPR that will propose as a participant and also by providing technical services along with the financial services to the borrowers to strengthen their activities. As a conclusion, low level income community including micro and small enterprises is a good and very potential customer. The complete story of the Micro Credit Project could be found attached.

[6] Project with GTZ, a Germany Government Technical Assistant Agency. Even though this project terminated in 1999, it continued with some further assistance from BI

IV. The Development of Islamic Banking in Indonesia

1. Background

The development of modern Islamic banking in Indonesia was formally initiated in 1992, in line with the enactment of Banking Act No. 7 Year 1992 which includes provisions that provide an opportunity to develop interest-free banks. Based on this Act, Indonesia has recognized the existence of a dual banking system, that is a system where the conventional side by side with Islamic banking system grow together to serve the economy. In the same year the first Islamic bank – *Bank Muamalat Indonesia* – was established in Jakarta and some rural Islamic banks also established in some rural regions in Java.

To encourage network enlargement in 1998 the government amended the banking act with a new Banking Act No. 10 Year 1998, which provide a wide opportunity and a stronger legal foundation for Islamic banking operations. A notable change in this act was the opportunity of conventional bank to open Islamic banking unit by recognizing dual system bank. In addition in 1999 through amendment of Central Bank Act with Act No. 23 Year 1999 concerning Bank Indonesia, the central bank is allowed to conduct monetary control through Islamic banks with instruments that based on Islamic principles. Since 1999, there were some new players come into the industry and the industry has made a steady progress. As at February 2003 the Islamic banking industry is represented by 2 full Islamic banks, 8 conventional bank which open Islamic banking units, and 85 Islamic rural banks.

2. The Concept of Islamic Banking

Islamic banking is the banking system operated based on Islamic law. Because of this, Islamic banking is different to conventional banking system in several ways. Technically, there are three distinctive features differentiating Islamic banking from the conventional one. Those are: the prohibition of interest in every economic transaction; the prohibition of conducting gambling activities; and prohibition of investing in (morally) non-legitimated investments.

The prohibition of interest in the transactions – Islamic finance recognizes the concept of money value of time rather than accepting the concept of time value of money, especially when the money is invested in activities to produce various products and services. Return from the investments should not be fixed and predetermined since the investors and the entrepreneurs should share in facing financial uncertainties, although they are still allowed to set the financial expectations.

The prohibition of gambling activities – Islamic finance promotes the use of any financial resources real sector economic activities; thus, all financial transactions should have underlying transactions.

(Morally) legitimated investments – The economic transactions should contain products and processes that are legitimated from the Islamic jurisprudence point of view. Some examples of transactions that are not legitimated include:

investment in a highly polluted industry, involving criminal activities, prostitution, alcohol containing foods/beverages and industries that potentially deteriorate the moral fiber in the society.

3. Modes of Financing

Conceptually, the focus of Islamic modes of financing is on profit And Loss Sharing (PLS) as an alternative to interest-based financing. However, Khan (1995) reports a divergence between theory and practice in the order of preference for these modes of financing. Most Islamic banks depend on mark-up based techniques. To understand this controversy, we need to go deeper into the basic features of Islamic financial techniques. There are five basic modes of finance: trustee financing (*mudharaba*), joint financing (*musharaka*), leasing (*ijara*), purchase with deferred delivery (*bai' al-salam*) and mark up (*murabaha*). All of the Islamic financial techniques, practically and theoretically, are reflected in these five basic models. Each basic model has its own financial characteristic that differs from the others.

Mudharaba is the most risky mode of financing since the capital-provider (an investor / bank) does not have control over the management while it has to be responsible for the whole of any financial losses arising from the use of such financing.

In contrast with *mudaraba*, *musharaka* is less risky since the capital-provider has some control over the business, besides other parties who are also risking their own capital in the business.

The practice of leasing (*ijara*) in Islamic banks is just the same as the leasing techniques adopted by conventional banks. The finance provider puts at stake the whole of his capital investment as well as the opportunity cost of capital for the whole period until the capital is received back.

In case of *bai' al-salam,* although the return has been fixed at the beginning of the contract, there is still uncertainty over the future prices of the commodities involved in the contract. Therefore, the capital provider has to be able to forecast the future price of the commodities.

The safest mode of financing in Islamic banking is mark-up (*murabaha).* The finance providers bear risk only for the period in which a spot sale is to be made and the goods handed over to the client. Mark up based financing just requires knowledge of the current prices of the goods to determine the financing and return on it. In many cases, if the financial providers do not know the appropriate level of return, they use other financial indexes as a benchmark, like interest rates. The comparative features of Islamic financing techniques are summarized in Exhibit 1.

Exhibit 1. Comparative Features of Islamic Financing Techniques

	Mudharaba	Musharaka	Leasing	Mark up	Bai' al-Salam
Nature of financing	Investment base	Investment base	Leasing base	Combination of debt and trading	Combination of debt and trading
Role of capital provider in management	Nil	Full control	Full control on the use of finance	Full control on the use of finance	Nil
Cost of capital	Uncertain	Uncertain	Fixed and predetermined	Fixed and predetermined	Relatively fixed and predetermined

Source: Khan(1995)

4. The Performances of Islamic Rural Bank in Indonesia

Since the legalization of Islamic principles as one of Indonesian banking system based on the new Banking Act, in May 1998, the investor intention to establish rural banks under Islamic principle (BPRS) is very high, although Indonesian economic is still under pressure originated by the economic crises started in 1997. Geographically, spreading map of BPRS usually more concentrated in Java Island. The number of BPRS as of December 1998 is 78 units and increase to 85 units as of December 2002. This presents that public give good responds to banks under Islamic principles. As an illustration of a success BPRS in Indonesia, attached is a profile of one BPRS including its financial performances.

As of December 2002, the total assets was Rp165,046 millions, increase 104.8% compared to the position as of December 1998 (Rp80,579 millions). Furthermore, total third party deposits increase more than 174%, from Rp35,550 millions as of December 31,1998 to Rp97,457 millions at December 31, 2002. Those data shows that the rural banks under Islamic principles has been accepted by the public and get people trust. Islamic rural finance is mostly allocated for short term trading activities as illustrated below and most of them are used in the commercial sector.

Modes of finance

1	Trading	86.6%
2	Venture capital	7.5%
3	Join financing	3.0%
4	Others	2.9%

Sector of industry

1	Commercial	82.1%
2	Small scale industry	1.5%
3	Services	3.2%
4	Others	13.2%

However, most of the loans are used for working capital purposes and only 5% is used for investment. The volume of financing is also small. The data below shows that most of loan is not for investment purposes since 64.7% of the loan is below Rp10 million.

Use of Financing

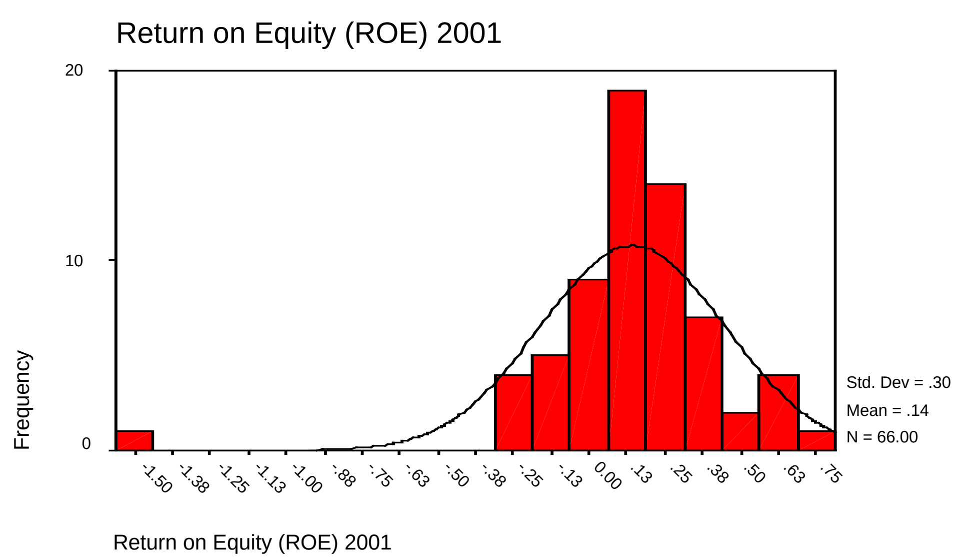
1	Working capital	92.5%
2	Investment	5.1%
3	Consumptive	2.4%

Volume of financing

1	Up to 1 mio	6.1%
2	1 – 5 mio	43.5%
3	5 – 10 mio	15.1%
4	Above 10 mio	35.3%

The financial services given, is used to strengthen working capital of the entrepreneurs in relatively small scale of products as illustrated below (mostly between 1 million to 10 million Rupiahs or equivalent to USD 100 to USD 1000).

Islamic Rural banking as an industry generates relatively moderate returns to the shareholders i.e. 13 to 15 percent annually, which is relatively higher that the market interest rate. The variation of the ROE of the industry, graphically, is shown below.



Currently, the banking regulatory authority applies the regulatory framework which is the same with the one applied to interest based rural banks, since both Islamic rural bank and rural banks need the same type of corporate governance to optimize the managerial performance. Islamic banks currently also adopt almost the same risk management concept as compared to the interest based one, such as the application of collateral or any other credit enhancements on the lending side.

The only thing different is the Islamic banks would never levy excessive return to the borrowers.

V. Challenges and Prospect

1. Challenges

It is recognized that challenges faced in the developing of Islamic banks in Indonesia are both operational and macroeconomic in nature. There are three major problems having been associated with the low level of development of Islamic banks, namely: (i) The concept of modern Islamic banking is relatively new in the country. Therefore the majority of people still do not have a clear concept of what the Islamic banking system is, including products offered by it; hence, benefits offered by the Islamic banking system have not been fully recognized; (ii) Inadequate Islamic banking infrastructures. This can be exemplified by the lack of special designed regulations that specifically for Islamic banking activities; and (iii) Lack of human resource expertise in Islamic banking. It seems that the development of expertise among the Islamic bankers, at best have been undertaken on an ad-hoc basis, relying largely on practical experience rather then any form of formal training. It was obvious that it needs to develop a more structured approach to human resource development in Islamic banking and Islamic economics.

The resolution of certain problems will be a complex matter. While there are no easy solutions, the active and strong commitment of the government and close collaboration among the players both at the national and international level, will help pave the way to overcome these limitations. From the side of the central bank, Bank Indonesia have formulated strategies for the development of an Islamic banking system which can be summed up into 4 major steps:

(1) further strengthen and improve the legal framework for the co-existence of an Islamic banking system. It should be paralleled with the development of regulatory instruments, to create a sound Islamic banking system.

(2) develop a network of Islamic banks in order to provide greater access for the public in utilizing Islamic banking products and services.

(3) create and develop monetary instruments that could support both monetary objectives on a macro economic level as well as the operational objectives of Islamic banks.

(4) socialize the Islamic-banking concept to the public, as well as to conduct training for the development of human resources.

In implementing the aforementioned strategies, Bank Indonesia has conducted the followings:

- Established a Islamic Banking Development Committee, which consists of Oversight Committee, Expert Committee and Working Committee.

- Itemized and assessed existing regulatory instruments in order to develop a more comprehensive set of rules and regulation toward the creation of a conducive environment for the development of Islamic banks. Among the set of rules and regulation that have been issued or are currently being researched upon are:
- The issuance of decrees by the Board of Managing Directors of Bank Indonesia concerning Islamic commercial and rural banks which have provided legal framework in developing and enlarging network of Islamic banks .
- The issuance of regulation on some operational guidance for Islamic banks, including Inter- Islamic Bank Money Market, Liquidity Instrument based on Islamic Principles, Statutory Reserves and Clearance System for Islamic Banks.
- Conducting assessment on the development of prudential banking regulations for Islamic banks and developing accounting standard for Islamic banks.

In order to develop human resources and expertise in Islamic banking, Bank Indonesia has conducted several education and training programs, and conducted seminar on Islamic banking, with the assistance of the overseas experts and Islamic financial institutions. In addition, Bank Indonesia currently active in conducting socialization of Islamic banking to the public, enabling the public to gain a better perspective of Islamic banking.
In addition to BPRS, Bank Indonesia has put some efforts to foster BPRS development in many ways namely:

<u>Technical assistance</u>
One of the obvious problems seen as major weaknesses in the BPRS is the capability of the account officer to identify real prospective projects to finance. Based on this evident, Bank Indonesia with collaboration with leading management consultants in Indonesia has provided courses to improve the actuarial skill of the account managers in BPRS institutions. The events are planned to be conducted periodically to cover significant aspect preventing the industry from developing well.

<u>Supporting strategic alliances with Islamic commercial banks</u>

Following the current trend about the economic of scale, Bank Indonesia has also support strategic alliances between BPRS and Islamic commercial banks. BPRS serve as effective channel to reach the rural and remote areas; the Islamic commercial banks, in turn, do not have to allocate their resources excessively to attain that objective.

2. Prospect

The prospect of Islamic banking can be explored from demand and supply side. It seems that the demand for Islamic banking is quite big and promising. Based on several surveys conducted recently, there were found that many low and middle businesses, avoided to make any deal with conventional banks because they believe interest rate is worried alike *riba*. Those surveys were followed by an empirical research that conducted in year 2000 and 2001 which emphasized the need of Islamic banking in Indonesia. The research covering 6 provinces in Java and Sumatera (+/- 5500 respondents) conducted by Bank Indonesia with several universities showed that averagely 40% of respondent believe that interest is contradictory to Islamic principles and prefer to use Islamic Bank if available and close to their areas. While 68% of respondents agree with the profit sharing system and perceive this system posses benefits. The opportunity to grow is large, for instance from the research conducted in West Java (2000) there was 42% of respondent of who prefer and feel comfortable to use Islamic banking which considered comply to Islamic law.

Moreover, the paradigm of people regarding the Islamic bank day by day shifts to get better understanding about this subject. The reason of paradigm shifting is that the socialization program conducted by Bank Indonesia and other institutions explain not only to focus on applying Islamic banking as a moral obligation but also to focus on understanding Islamic Economics and Islamic Banking as a science. The target of the socialization program covers the Islamic scholars, practitioners, academician, student and community in general. Therefore, through this socialization program, we may see in the near future that the user of Islamic banking not only Moslem people.

As we know from the demand side, there is a demand for product and services of Islamic bank. However, the networking regulation which was very rigid cause the Sharia Business Unit of the conventional bank face difficulty to expand their networking. Therefore, Bank Indonesia in March 2002 just issued a new networking regulation that covers about:

(i) Opening Islamic banking sub-branch within its conventional branch
(ii) Opening an Islamic banking services unit within a conventional branch as a transition period in order to fully convert as full Islamic branch.

Hopefully, with this new regulation will invite many new players so that the people in many potential regions will be served. Furthermore, since Indonesia has set the program to develop a dual banking system, in other words allowing interest-free banks to be established, we need to take necessary measures to regulate and support them. It is necessary to ensure that such institutions have sound management, adopt healthy practices and do not indulge in speculation. Such institutions should be subjected to regular inspection by central bank and their final accounts should be carefully examined. It is therefore Bank Indonesia as the banking authority has full commitment, beside it is imposed by Central Bank Act, to consistently formulate and improve the legal framework and regulation to provide a conducive atmosphere for development of efficient and competitive Islamic banks. Cooperation and involvement of other government institutions are necessary; for instance in reforming tax system which can help to accelerate the development of Islamic banking and finance, in nurturing the growth of non-bank financial institutions, specialized legal institution etc.

The development of Islamic banks in Indonesia has showed a significant progress, but its role in the economy is still small. As it is envisioned that Islamic banking industry should achieve a significant contribution and play a greater role in national economy, Bank Indonesia has set up a long term planning for the next 10 years which divided into three phase of implementation. This plan is very important in accelerating the growth of Islamic banking, enlarging its share in national banking system and driving the industry toward greater equity-based financing. This plan also considers the international progress of Islamic financial infrastructures, such as the establishment of International Islamic Financial Market (IIFM) in November 2001 and Islamic Financial Services Board in this year. The first phase is laying foundation for growth so that Islamic bank can be an alternative bank for the Indonesian people. Then the second phase is strengthening the industry to have more role in driving the real sector. Finally, the third phase is becoming a world industry through improving Islamic banks performance, increasing competitiveness among the industry and shifting dominance of trade related financing modes toward PLS schemes.

VI. CONCLUDING REMARKS

1. Indonesia has a long history of microfinance for more than 100 years ago. The key success of microfinance in Indonesia is a close locatation to the community that really needs, simple procedures and personal approaches. However, microfinance that operated professional and based to the market increase their competitiveness .
2. The success credit program supported by the donor enhancing microfinance programs also fulfilled with assistance from international institutions, such as in the field with PHBK projects (Self-help group linkages to banks) from 1989 and PKM (microcredit project). Both programs record a success for developing micro-businesses in the rural areas, improving income and job opportunity in rural areas.
3. Islamic Banks that are commercial banks and rural banks are legalized in 1998 based on the Banking Act No. 7 of 1992 as revised by the Banking Act No.10 of 1998 although the existence of Islamic non-bank financial institutions was already started in 1968, before a formal Islamic legal base existed. The banking regulatory authority applies the same regulatory framework for both Islamic rural banks and conventional rural banks since both of them need the same type of corporate governance to optimize the managerial performance.
4. There are three distinctive features differentiating Islamic finance from the conventional one: the prohibition of interest in every economic transaction; the prohibition of conducting gambling activities; and, prohibition of investing in (morally) non-legitimated investments. The focus of Islamic modes of financing is on profit and loss sharing as an alternative to interest-based financing
5. We will support donor to participate in supporting the Islamic rural bank either in terms of financial or technical assistances. The program of financial assistance should not be based on interest rate but based on Islamic principles such as profit and loss sharing scheme.

UKABIMA: AN INTEGRATED SUSTAINABLE APPROACH TO PROVIDE FINANCIAL ACCESS TO THE POOR THROUGH BANK PERKREDITAN RAKYAT (BPR)

A. Background

PT. Usaha Karya Bina Mandiri (Ukabima) is a specialized company dedicated its business with the primary objective to provide financial access to the poor through regulized microfinance institution, Bank Perkreditan Rakyat (Rural Bank) – BPR, in Indonesia. Ukabima was formed in 1996 and owned by three Indonesian shareholders. The shareholder's idea of developing a business model tot assist the poor through a for-profit approach to assure financial sustainability was supported by CRS – a U.S.-based relief and development organization, with the financial and technical support of the U.S. Agency for International Development (USAID) and the Societe d'Investissement et de Development International (SIDI-France).

B. Products and Services Provided to BPR Network

Basically Ukabima provides 3 business services:

i. **Equity participation in BPR**. Currently Ukabima holds 70% of BPR BMMS shares, 60 % of BPR Ukabima Lestari shares and in the process to acquire 60% shares of BPR Mulyo Raharjo and BPR Yuwana.
ii. **Loan to BPR**. In order to support BPR to provide financial service to the poor by providing working capital to micro enterprises, Ukabima provide loan to qualified BPRs. Currently 43 BPRs have loan from Ukabima.
iii. **Technical Assistance**. Ukabima believe that only sound and well- managed BPR will be the one that able to convey quality service to the poor. In order to strengthen BPR capacity, Ukabima provide the following technical assistance:
    1. **Annual Network Meeting**. The annual network meeting is a forum that Ukabima facilitates to enable the BPR management and Board to share experiences. Cases, best practices, industry trends, environment changes and new initiatives is being discussed in this forum.
    2. **Training.** Ukabima provide training to BPR at the Board level (Commissaries), Management level (Directors and Managers), Field Officers (Account officers and Savings/Deposit officers), Front-desk officers (Teller, Customer Service and Cashier), Back-office officers (Adminstrator, Accountant and IT officers) and Internal Auditors. The training is conducted at provincial and national level.

3. **Consulting & Supervision.** Regularly, Ukabima reviews BPR performance and discussed with the BPRs on the necessary action to be made for the better performance of BPR.
4. **Ratings**. Ukabima develop a monitoring system through a self-developed rating procedures (we call it Komodo Rating). The rating system provide indicators on the soundness of BPR, impact to the community and risks.
5. **System**. Ukabima developed an integrated software system for BPR (with a brand name MFI-2000) that covers accounting, loan management, savings management, time deposit management, data for report to Bank Indonesia, reports comply to CGAP financial indicators and other executive information system.
6. **Product Development**. Since 2001, Ukabima develop new product called Kusuma (**K**redit Kus**us** **U**ntuk **M**asyarakat Miskin tanpa **A**gunan) – a special loan windows for the poorest. The product was tested in BPR BMMS and able to reach financial break-even point within 13 months. Financing of the loan come from community savings with cost of fund 13%. With the success of testing period, Kusuma has been replicated in 4 other BPRs and reach the financial BEP in 18 months due to the source of funds coming from loan that is bearing higher interest rate (18% per annum). This product is another example of a sustainable model to provide loan to the poorest. In addition of the fact that the BPR run Kusuma loan reach their financial profitability, the BPR also able to expand outreach to the poor. Within 2 years time, the 5 BPR able to serve 5,300 Kusuma clients.

C. Selection of BPRs

BPRs join the Ukabima system through a tough selection. There are 3 stages that BPR should undergo in this process.

Stage-0: The objective of the S-0 evaluation is to ensure that the BPR shares the same vision and mission with Ukabima, has a sound reputation within its community, and a strong Board of Directors and management structure are in place and functioning. This process is undertaken to prevent Ukabima's dealing with partners aiming only for profit or social impact, and who may be looking to "legalize" money-lending practices.

Stage-1: The objective of S-1 evaluation is to assess the BPR business prospect (market size, competition, demand for service), management capacity (education, experience in banking, leadership style), operational (system and procedures, MIS, accounting), risks (asset and liability management, leverage, liquidity, financial efficiency, productivity), product and services (savings and credit, performance of each product), and collateral appraisal.

Stage-2: The S-2 evaluation is basically a financial assessment to ensure that checks and balances systems are in place.

D. Partnership and Networking

Ukabima work hand in hand with other institutions that share similar vision and mission. Ukabima work closely with Bank Indonesia as the Central Bank and supervisory of BPRs, Association of BPR (Perbarindo), GTZ and other national players in the industry from banking, holding company and NGOs.

In the international level, Ukabima work closely with CRS Microfinance Network, USAID, Microfinance Alliance Fund of Philippines, Cordaid of Netherland, SIDI of France and others.

E. Ukabima BPR Family Indicators

Through 44 BPR in the network, total borrowers and savers are 51,470 and 130,511, respectively. The percentage of women borrowers is 40% (note: collateral is typically in name of husband, so figure is underestimated). The average loan size is US$363, with arrears over 90 and 180 days at 4% and 2%, respectively. The consolidated loan portfolio is valued at US$18.6 million, consolidated savings and time deposits at US$11.5 million, consolidated profit at US$.8 mn, consolidated net worth at US$3.0 million, and consolidated return on equity (annual basis) at 36%. With 89% of BPRs borrowing from Ukabima having a profit of greater than 20% its equity, and 76% with a profit of more than 30% of its equity, the institutions are strong.

Ukabima itself is a company with US$ 3.2 million assets, loan portfolio to BPR US$2.7 million, profit at US$140 thousands, net worth at US$ 670 thousands, portfolio at risk over 30 days 1%.

F. Lesson learned

BPR is a reliable model to assist the poor with their micro enterprises through commercial approach. However, it is still a concern to support BPR to reach more clients to enable the BPR contribute more role in the community financial business and/or economy.

Ukabima learned that giving loan only to BPR is not enough. Though the one that generate income for Ukabima is the loan to BPR, technical assistance is integral parts of the model that become assurance of business quality, at Ukabima level and at BPR level. Close relationship between Ukabima and BPR goes beyond lender and borrower. It more as business partner where problem is being discussed, solution is being developed and implementation is tightly being monitored. In turn, the technical assistance is become the “collateral” for Ukabima loan investment in BPR and mission to provide financial access to the poor.

BPR Management highly value the Annual Network Meeting that Ukabima provides, where the BPR is able to share experience, exchange best practices and examine new ideas. This is an indication that BPR value their owned wealth of knowledge and willing to distribute to other BPR to shape better performance across other.

UKABIMA PERFORMANCE COMPARISON 2002 - 2001

FINANCE	2001	2002	Var (unit)	% Var	In US Dollar 2001	In US Dollar 2002
Assets (Rp billion)	19.93	27.97	8.05	40%	2,303,932	3,233,990
Portfolio (Rp billion)	14.18	19.70	5.52	39%	1,638,960	2,277,458
Profit (Rp billion)	0.71	1.19	0.48	67%	81,965	136,994
PAR > 30 days (Rp billion)	0.214	0.167	-0.047	-22%	24,740	19,306
PAR > 30 days (%)	1.51%	0.85%	-0.66%	-44%		
Income (Rp billion)	2.69	4.33	1.64	61%	310,867	500,694
Loan interest income (Rp billion)	2.60	3.66	1.06	41%	301,041	423,237
Cost of fund (Rp billion)	0.70	1.35	0.65	92%	81,387	155,954
Operational cost (Rp billion)	1.15	1.84	0.69	61%	132,370	212,486
Average loan portfolio (ALP)	10.49	16.94	6.44	61%	1,213,180	1,958,209
Long term debt (Rp billion)	14.00	20.73	6.73	48%	1,618,498	2,396,880
Average Equity (Rp billion)	4.26	4.94	0.68	16%	492,833	570,896
Average Assets (Rp billion)	14.95	23.95	9.00	60%	1,728,209	2,768,903

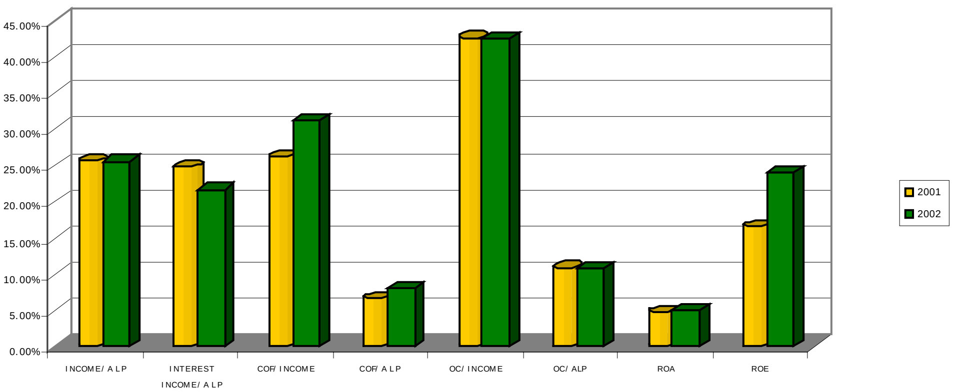
RATIOS	2001	2002	Var (unit)	% Var
INCOME/A L P	25.62%	25.57%	0%	0%
INTEREST INCOME/A L P	24.81%	21.61%	-3%	-13%
COF/INCOME	26.18%	31.15%	5%	19%
COF/A L P	6.71%	7.96%	1%	19%
OC/INCOME	42.58%	42.44%	0%	0%
OC/ALP	10.91%	10.85%	0%	-1%
ROA	4.74%	4.95%	0%	4%
ROE	16.63%	24.00%	7%	44%
DER	328.41%	419.85%	91%	28%

OUTREACH - BPR REGULAR	2001	2002	Var (unit)	% Var	In US Dollar 2001	In US Dollar 2002
#BPR	42	44	2.00	5%		
# Borrowers @ BPR	46,816	57,396	10,580.00	23%		
# Savers @ BPR	123,644	141,878	18,234.00	15%		
Loan portfolio (Rp billion)	129.73	191.02	61.29	47%	14,997,696	22,083,249
Savings (Rp billion)	86.35	119.81	33.46	39%	9,982,896	13,851,337
Avg loan (Rp thousands)	2,711	3,328	617.11	23%	313	385
Avg savings (Rp thousands)	698	844	146.49	21%	81	98
% women clients	38%	52%	14.0%	37%		
PAR > 30 days	6.0%	4.8%	-1.2%	-20%		

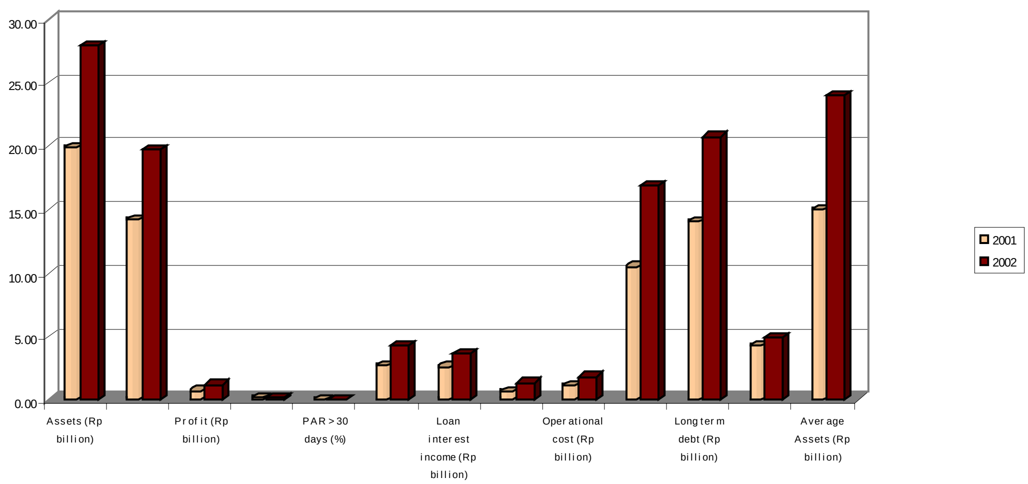
OUTREACH-KUSUMA	2001	2002	Var (unit)	% Var	2001	2002
# BPR	5	5	0.00	0%		
# Kusuma group	84	232	148.00	176%		
# Members/Savers	1,749	4,776	3,027.00	173%		
# Borrowers	1,728	4,776	3,048.00	176%		
Loan portfolio (Rp million)	396	1,191	795.00	201%	45,780	137,688
Savings (Rp million)	48	230	181.50	378%	5,549	26,532
Avg Loan (Rp thousands)	229	249	20.21	9%	26	29
Avg Savings (Rp thousands)	27	48	20.61	75%	3	6
% women clients	100%	100%	0.0%	0%		
PAR > 30 days	0%	2.37%	2.4%	#DIV/0!		

Note:
Rp 8,650 = 1 USD
Rp 1 million = 115.6 USD
Rp 1 billion = 115,607 USD

Notes:
PAR = Balance of Portfolio with arrears (>30 days) / outstanding porfolio



FINANCIAL PERFORMANCE



Attachment 2

SUCCESS STORY OF MICRO-CREDIT PROJECT (PKM)

1. Background of PKM

Capital procurement has been the largest constraint encountered by the micro enterprises in Indonesia's rural areas. This is because financial institutions, which can effectively fulfil the capital requirements, are very scarce. Managerial capacity, product marketing, and profit-identifying capacity have been the other constraints, not to mention the lack of technology and equipment.

Rural financial agencies were required to provide service centers in the vicinity of their borrowers so as to reduce transaction costs especially for the micro customers. Commercial banks in general could not cover their overhead costs if they to serve micro customers living in the scarcely populated areas. On the contrary, small financial institutions including BPR-*Bank Perkreditan Rakyat* and LDKP-*Lembaga Kredit Dana Pedesaan* (where the overhead costs are smaller), could be domiciled near the micro customers in the rural areas, to provide an effective and sustainable financial services.

PKM aimed at enhancing the capacity of the financial institutions selected to implement the said task. This project was the project of Bank Indonesia in cooperation with the Asian Development Bank based on Loan Agreement ADB Loan No. 1327-INO (SF) which was signed between the Government of the Republic of Indonesia and ADB on January 10, 1995, and came into effect as from July 21, 1995 and ended in December 31, 2001.

The willingness of ADB to finance PKM in Indonesia was due to the success story of LKDP and a number of poverty alleviation projects in Indonesia amongst other the Income Generating Project for Marginal Farmers and Development of Linking Banks and Self Help Group. Since the 1970s, many rural financial and credit agencies have been offering credit to the people in their communities. LKDP and BPR have proven themselves as assisting the people and micro businessmen to improve their performance so as to broaden their service area. NGO's (LPSM-*Lembaga Pengembangan Swadaya Masyarakat*) assistance was required to educate the people of rural areas so as to make it possible for them to increase their income. This was due to the fact that many of them were untouched by the Government's technical development and assistance. Therefore, PKM has made efforts to enhance the capability of LPSM (NGO's) in developing micro enterprises.

2. Objectives, Strategy and Scope of Project Activity

PKM objectives covered 2 aspects as follows:

a. To improve income and job opportunity in rural areas including to enhance women's role in development activities as well as to overcome poverty.

b. To develop micro businesses in the rural areas through strengthening BPR, LDKP and LPSM as well as credit distribution to micro entrepreneurs both individual and group.

The objectives mentioned above may be achieved by enhancing the "PKM" strategy directed to the following approaches: supply side and demand side. From the supply side, PKM activities were to strengthen BPR, LDKP and LPSM; and from demand side to provide credit for micro borrowers.

Strengthening BPR and LKDP was materialized through credit provision (for computers and motorcycles) as well as training so as to broaden the financial services aimed at sustainable development and financing provided for micro businesses. Similarly, strengthening LPSM was conducted in a manner so as to enhance its capability in organizing the low-income people groups and poverty, providing vocational training in line with other activities to improve income. From the demand side, the PKM activities were aimed at credit distribution to new micro customers in developing their businesses; channeled through BPR and LDKP.

3. Work Area

Credit provision of PKM in the first stage included five provinces namely West Java, Central Java, East Java, South Kalimantan, and West Nusatenggara. These five provinces were selected due to the number of BPR and LDKP that had fulfilled project requirements and the relative number of poor people. PKM was extended to the other nine provinces in 1998, namely: Nangro Aceh Darussalam (NAD), North Sumatera, West Sumatera, Riau, Bengkulu, Lampung, Special Region of Yogyakarta, Bali, South Sulawesi and North Sulawesi. Therefore, fourteen provinces covering 22 Bank Indonesia Branches have been subject to PKM scheme implementation.

4. Participant Institutions and Participation Requirements

PKM participants consist of BPD-Bank Pembangunan Daerah (Regional Development Bank) domiciled in the implementing areas of PKM, BPR and LPSM which meet the requirements and had to be determined and involved as PKM participants. The said institutions had to meet the requirements stipulated by BI to become PKM participants which are :

a. Requirements for BPR

- The minimum rating should be fairly sound during the last three months.
- The Capital Adequacy Ratio (CAR) level should be minimum 8%.
- Minimum Loan Recovery Rate should be 80% stated with KAP that is at least fairly sound.
- Managed by a responsible and experienced management seen from the management appraisal result, which should be fairly sound.
- The debtor portion should be with a credit ceiling less than Rp. 2,000,000 (equivalent to USD 222) with a minimum of 5% of all the debtors' amount.
- Ratio should be between the entire public financial amount collected and the entire credit amount with a minimum of 10%.
- Having a mission to participate in developing micro businesses.

b. Requirements for LPSM

- Having been registered for minimum 2 years, at the competent authority.

- Having a minimum 2-year experience in (a) group saving, (b) implementing micro credit distribution to the group being-developed.
- Showing capability and willingness to assist the establishment, development and cultivation of micro businesses.

On the basis of the requirement mentioned above BI had to make pre selection of the existing BPR and LPSM in the respective areas by analyzing data related to fulfillment of the institutional requirements of PKM participants.

5. Credit Conditions

Credit fund distribution was the main activity in the PKM implementation. This credit fund should be guaranteed to reach its target, namely the participants' institutions and the micro borrowers. Therefore, BI provided terms and conditions on PKM crediting as follows:

a. Financial Provision

PKM should provide PKM credit fund to BPR and LPSM to purchase computers and motorcycles as well as credit provision to BPR to lend to its micro customers. The fund provided for this purpose would depend on the prospective participant requirements, the amount of which would be defined by the BI evaluation on the computers and motorcycles needed. This would definitely be required, in addition to the capability of BPR in obtaining and providing credits to new micro customers in a year.

b. Credit requirements

- BPD shall be obliged to distribute credit received from BI to LPSM amounting to the entire ceiling given by BI, in a period of 15 days at the latest after credit transfer date.
- BPR shall be obliged to distribute credit received from BI to new micro borrowers.
- BPD and BPR shall assume the responsibility in returning credit received.
- BPR shall be obliged to maintain credit that is provided for micro enterprises but not to be used for any activity harming the environment.

c. Credit interest rate

Credit interest rate given by BI in the context of PKM scheme shall be as follows:

- BI interest rate for BPD both to purchase computer and vehicle shall be reference rate.
- Credit interest rate from BPD forwarded to LPSM shall be 2% above reference rate.
- Credit interest rate from BI to BPR shall be 2% above reference rate.
- Credit interest rate from BPR to micro borrowers is market rate applicable in respective areas.

- Reference rate is SBI rate, the rate of interest, expressed on an annualized basis, prevailing for 90-day Rupiah denominated certificates of deposit issued by BI.

d. Credit period

Credit period for BPD to purchase computer and vehicle shall be 10 years, whereas credit to be forwarded to LPSM for computer and motorcycle will be 5 years. Credit period for BPR to purchase computer, motorcycle and credit to lend to micro borrowers shall be 5 years. Credit period provided by BPR for its micro borrowers shall be 18 months at the most.

e. Credit distribution to micro borrowers

The credit realization from BPR to micro entrepreneurs each month will amount to 10% at a minimum out of the amount of loan for micro entrepreneurs drawn from BI. This should be realized entirely at the latest 10 months after the authorization date from BI to BPR. Realization of computer and motorcycles by BPR and LPSM is to be carried out one (1) month after the authorization date by BI.

If the credit distribution, computer and motorcycle purchasing mentioned above do not reach the provision above, the participant corporation will be subject to penalty, namely to pay the average interest of the 3-month time deposit during the last month applicable at Commercial Bank, calculated from the amount of deficiency of distribution per month of credit for the customers and the retained fund for purchasing computer and motorcycles.

At BPR level, the amount of credit ceiling is stipulated to be provided to micro borrowers, as follows:

- First credit, provided at a maximum Rp.2,000,000 per borrowers (equivalent to USD 222) in accordance with business requirement,
- Repeated credit may be considered in stages Rp.5,000,000 (equivalent to USD 555) at the most per borrowers according to the smoothness of credit payment and business requirement.

Credit distributed to micro borrowers by BPR may entail an additional collateral requirement. Credit distributed in particular by BPR to micro businessmen group, where businessmen are financed by micro businessmen group formed and developed by LPSM being PKM participants. LPSM forming micro businessmen group that is linked to BPR shall be given compensation from BI. In addition to group forming task, LPSM may provide the following services to the micro businessmen group based on mutual agreement between BPR and LPSM. To this end, LPSM shall be given compensation based on agreement with BPR.

6. The Development of Project Performance

a. Development of Institution and Customers

The development of the amount of PKM Institution and borrowers in the month of December 2002 are as follows : The total Intitutions of project participants are

1.140 consisting of 843 BPR, 226 LDKP and 65 LPSM; The total number of borrowers who had received funds reached 930,235 persons, consisting of 84.19% individual borrowers and 15.81% in groups.

b. Realization of PKM Credit

The realization of the PKM credit to BPR as of December 2002 reached a total of Rp. 270,48 billion. The realization of the PKM credit consists of Rp 6,11 billion (2,3%) of the credit for purchasing computers, Rp. 7,3 billion (2,7%) for purchasing motor cycles and Rp. 257,0 billion (95,0%) micro credit to be lent to micro borrowers. Of the total credit realized to borrowers received by BPR it appears that Rp 608,0 billion was in rotation 1, 2, or 3 times. Average amount of PKM credit fund for customers per BPR/LDKP was 251,3 million. The average amount of borrowers per BPR/LDKP is 870 persons so that the average credit is Rp 288,850.

c. PKM credit collectability

Credit collectability per December 2002 at BPR level was encouraging, viewed from borrower number or PKM credit balance such as is given in Table bellow. Out of PKM outstanding amounting to Rp. 113,7 billion, NPL amounting to 9,66% only 2,06% was bad debt :

No	Collectability	Debit balance	
		Rp. Billion	%
1	Current	102.7	90.33
2	Sub standard	4.2	3.67
3	Doubtful	4.5	3.93
4	Loss	2.3	2.06
	Total	113.7	100

PROFILE OF BPRS AMANAH UMMAH

1. Location
   BPRS Amanah Ummah located at Bogor that directly bordering with DKI Jakarta areas. It's located nearby Leuwiliang traditional market.

2. Legal Entity and Year of Founded
   BPRS Amanah Ummah has legally registered as Perseroan Terbatas (PT) and founded on 18 Mei 1992 (operational license date).

3. Profile of Products

   a. Funding Products
      Per 31 December 2002, Amanah Ummah collected funds from society around 9.2 billion IDRs, increased 1.9 billion IDRs from last year (7.3 billion IDRs). During year 2002, the wadiah saving account had been increasing from 4.7 billion IDRs to 5.0 billion IDRs but its share in funds collected by the bank had been decreasing from 64.27% to 54.08%. In other side, mudharabah time deposit share increased from 35.73% to 45.92%. Thus this fact indicates the banks credibility increasing.

   b. Financing Products
      Per 31 December 2002, Amanah Ummah distributed funds to society around 8.6 billion IDRs, increased 1.4 billion IDRs from last year (7.2 billion IDRs). Most of them (98%) are in the form of murabahah. A little portion is in the form of mudharabah (0.01%) and ijarah/salam (1.99%).

4. Socializing and Promoting BPRS
   Amanah Ummah primarily uses "jemput bola" method in socializing and promoting their bank. "Jemput bola" is a proactively action by directly visiting the customers or potential customers. The next strategy of promotion is making contact with religion or society figures. Amanah Ummah also uses promotion facilities such as leaflet and brochures. Content of the leaflet is a general explanation about the bank and the products. Amanah Ummah has not utilized advertisement in newspaper, magazines, radio, or television.

5. Competitor
   Amanah Ummah sees other BPR(S) as not competitors. But they really concern about BRI Unit Desa, BCA, and other commercial banks since those banks have higher credibility.

6. Problems Facing by Amanah Ummah
   Facing the delinquency financing, Amanah Ummah has different solution despite of general solution based on Bank Indonesia guideline (restructuring, rescheduling, and reconditioning). To overcome the delinquency problem, Amanah Ummah formed Special Mission Team (STK- Satuan Tugas Khusus) consist of officers and management to visit the delinquency customer. Sometimes Amanah Ummah also use "debt collector" with profit sharing scheme (not by fee). Amanah Ummah also can get some help from religion or society figures in this situation.

7. Amanah Ummah Prospects
   Along with the rapid development of Islamic banking in Indonesia, the competition among Islamic banks become higher. This competition forced Amanah Ummah to be more competitive in services and profit sharing. But Amanah Ummah believes that the increase of public awareness on Islamic banking will deliver bright prospect for Islamic banking industry.

8. Commissioner and Sharia Board Roles
   Board of Commissioner of Amanah Ummah plays an important role in improving delinquency financings, making of Yearly Working Plan, and developing marketing strategies. The Sharia Board roles are in developing new products and improving delinquency financings.

9. BPRS Management
   a. Vision, mission and business planning
      Amanah Ummah has formulated its vision, mission, culture and motto. The vision is to make BPRS is the ummah (the public) choice and plays important role in development of ummah economics through sharia banking. The mission is to improve the quality of ummah life through Islamic banking and build trustworthy and professional BPRS management. The company culture is fast service, trustworthy, and friendly. The motto is Reach for profit, deflect riba, summons blessing.

   b. Operational guidelines
      Amanah Ummah has owned quite complete operational guidelines such as accounting, marketing, financing, funding, and personnel. The guidelines has standardized and in writing. Generally there is no problem on application of these guidelines.

   c. Application of information technology
      The Application of information technology in Amanah Ummah is quite simple and stand alone. The computer hardware quite sophisticated compared with other BPRS that is Pentium I until Pentium III.

10. Human Resources and Training
    a. Total and qualification of human resources
       Total personnel (management and employee) at Amanah Ummah are around 30 persons. According to the last educational level generally who are in the management position are Bachelor Degree (S1). The requirement for manager position besides knowledge about banking also ability to read Al Quran and understand Islam basic principles (Aqidah, Syariah, Akhlaq)

    b. Training activities
       Amanah Ummah has regular training program every year. All employees must enroll training about sharia banking products. The training activity conducted in-house, by management of Amanah Ummah as instructor and sometime by visiting lecturer. Besides that some training programs followed by Amanah Ummah are held by certain institution such as Bank Indonesia, ASBISINDO or APRACA.

Financing Portfolio of Amanah Ummah per 31 December 2002
Total Financing = Rp 8.590.179,00

Items	Number of account	Value	Percentage of value
Financing per sharia principles			
a. Murabahah	602	8,417,918	116.74%
b. Mudharabah	1	1,000	0.01%
c. Musyarakah	-	-	0.00%
d. Ijarah	87	171,261	2.38%
Type of Financing			
a. Working capital	450	5,284,745	73.29%
b. Investment	110	1,608,409	22.31%
c. Consumption	130	1,697,025	23.53%
Financing per sector			
a. Agriculture	1	6,875	0.10%
b. Industry	22	524,237	7.27%
c. Trading	470	5,304,096	73.56%
d. Services	55	946,048	13.12%
e. Others	142	1,808,923	25.09%

Funding Portfolio of Amanah Ummah per 31 December 2002
Total Funding = Rp 9.174.067,00

Items	number of account	Value	Percentage of value
a. Wadiah Saving Account	9,304	4,961,539	54.08%
b. Mudharabah Time Deposit	208	4,212,528	45.92%